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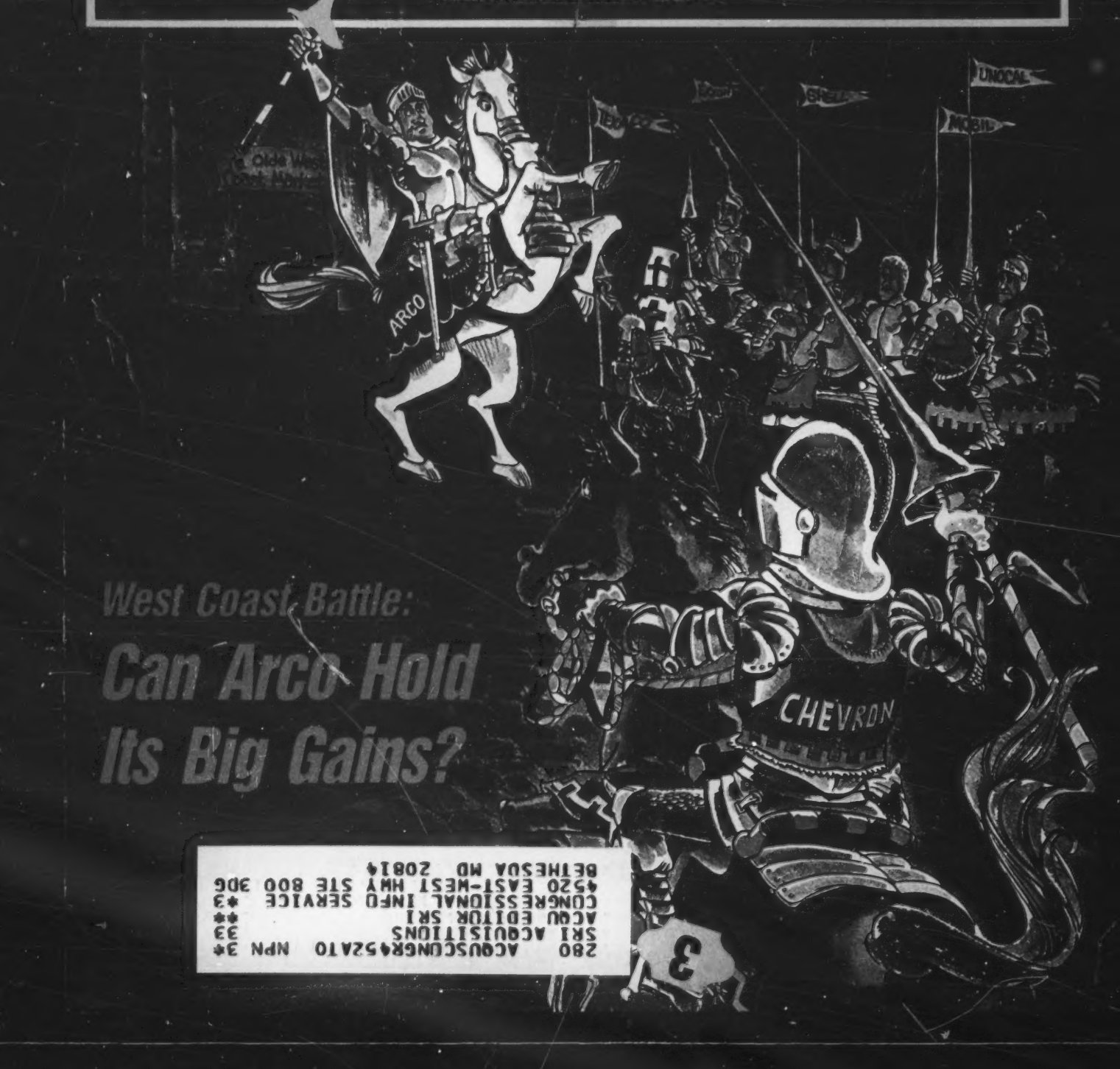
Shell Grabs Top Spot in Market S...
Why an Arkansas Jobber Likes Cardlocks
Marine Engines: Headache or Opportunity?

NPN

National Petroleum News



West Coast Battle:
Can Arco Hold Its Big Gains?

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NATIONAL PETROLEUM NEWS

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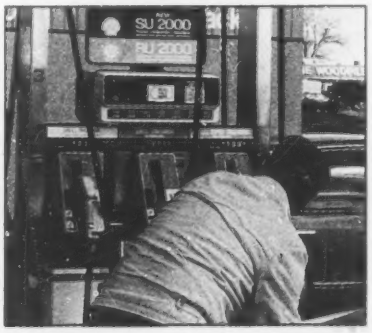
Arco's cash-only, low-price, high-volume marketing strategy has taken the West Coast gasoline market by storm. Now, major competitors are making moves to recapture market position lost to the region's most aggressive marketer. **Page 34**



Arco may be king of the castle on the Coast, but Shell has taken over as top gun in terms of national market share in gasoline sales. The company's service stations increased sales 11% in 1986, the best percentage increase among major companies. **Page 29**

The EPA-mandated lead phasedown presents both opportunity and potential liability problems for marketers who sell gasoline for marine engines and high rpm farm equipment. Some marketers see a growing opportunity in the sale of lead substitutes to offset unleaded problems for those types of engines. **Page 48**

• TRENDS

Oil Men Mustn't Ignore Energy Crisis Threat

History often repeats itself and may be on the verge of another go 'round for U.S. oil men. As frightening as the prospects of a third global oil crisis [*NPN*—March '86, p40], is the apathy among marketers about it. They seem to have a head-in-the-sand attitude that there's really no need to worry because of plentiful supplies of standby and alternate sources of oil, some of which weren't available during the last crunch in 1978.

Some marketers and association executives apparently believe OPEC has been counterbalanced by new and additional sources of supply in the North Sea, the Orient and the Western Hemisphere itself. This line of thinking also suggests that with production on the downside in the U.S., all we need do is open the spigot and this lost production just gushes forth presto-chango. A realistic viewpoint is that only $25 bbl. oil, which doesn't seem likely at this time, can reactivate exploration and production in U.S. oil fields and even then it will take several years to rebend the curve upward. If marketer apathy persists, the oil crisis can happen earlier and with much greater impact than already forecast.

Most major suppliers and the federal government are deeply concerned about another round of oil and price traumas in the early 1990s. And they're trying to get people to recognize it and at least start talking about potential solutions, no matter whose ox is gored. The latest DOE report wasn't simply another bureaucratic outburst; it was a distillation of input from a dozen federal agencies and 250 outside experts.

Facts simply do not support the notion that excess and potential supplies for the future are really very strong or quickly available. Consider these points:

1. In 1986, imports of crude and products moved upward for the first time since 1981. Almost half of these—46% to be specific—came from OPEC members. OPEC is composed of 12 nations—six Arab, six non-Arab. In 1986, the Arab segment shipped an average of 1,149,000 b/d to the U.S. and non-Arab members shipped 1,619,000 b/d for a total of 2,768,000 b/d.

2. The 54% imported by the U.S. from other nations amounted to 3,293,000 b/d. What few people realize is that the 54% came from more than 50 assorted nations—including the Soviet Union and some of its satellites. Some of these nations contributed only teacups full but they were nevertheless parts of the group that some marketers consider significant. The ratios are even more compelling: OPEC owns about 75% of the world's proved reserves of oil, the U.S. and its allies 25%.

3. The biggest exporters to the U.S. in 1986 were Canada, 790,000 b/d; Venezuela, 772,000 b/d; Mexico, 694,000 b/d; United Kingdom, 351,000 b/d; and the Virgin Islands, 243,000 b/d. But Venezuela is a member of OPEC and Mexico, while not a member, is often sympathetic to its causes and sometimes attends critical price and supply meetings as an "observer." The Virgin Islands is a U.S. territory and its role as an "exporter" is more technical than realistic.

4. All of the exporters can be counted on to increase oil and products to the U.S. as demand continues to rise in the face of excesses and cheap prices. But there are limitations on the production capabilities of the OPEC and non-OPEC sources alike. Remember that Saudi Arabia alone has almost 25% of the world's oil reserves while the combined reserves of Venezuela, Canada, Mexico, U.K., and the U.S. equal roughly 18%. If there's another crunch, many countries will be vying with the U.S. for more oil supplies.

5. Budget cutbacks have slowed the input to the Strategic Petroleum Reserve to a trickle. It now has slightly more than 500 million bbl., far from the 750 million bbl. it was to have had several years ago.

The oil industry, government and the American people must face facts and work to find solutions to this looming threat. —*J. Richard Shaner*

• MARKETPLACE AT A GLANCE

AVERAGE GASOLINE PRICES IN THE U.S. (per gal.)

FEBRUARY	Gasoline (All types)	Leaded Regular	Unleaded Regular	Unleaded Premium
U.S. City Avg.	$ .911	$ .848	$ .905	$1.047
Regions:				
Northeast	.912	.839	.887	1.034
North Central	.895	.843	.899	1.042
South	.914	.847	.906	1.044
West	.921	.859	.923	1.074

Source: U.S. Dept. of Labor, Bureau of Labor Statistics.

STOCKS (Add 000 bbl.)

	3/27/87	3/28/86
Gasoline (total)	245,801	225,468
Gasoline (Unleaded)*	136,960	116,053
Jet Kerosine	41,903	38,898
Distillates	106,308	95,143
Residual	38,224	39,387

**Included in gasoline total.*
Source: American Petroleum Institute.

Fuel Oil Bounces Back In Northeast Housing

Not since 1979 has the distillate heating oil industry done as well in new home construction in the Northeast as it did in the year just gone by.

Preliminary figures from the U.S. Department of Commerce indicate that fuel oil got 24% of the new homes that were built in that area in 1986.

That's an increase of 8% in the annual total, which has been bumping along discouragingly at 13% to 16% in recent years. In 1979, the heating oil industry commanded 36% of the new homes in the northeast.

It's obvious that the fuel oil industry still has a long way to go to get back to where it used to be, but at least the figures indicate a turnaround is in the making, one observer noted.

The national figures were on the upside for heating oil too. The preliminary data indicate that fuel oil's share of the total U.S. new home market was 5%. Not much, in one sense, but considering that the national level has been running only 1% to 2% in recent years, the 5% doesn't look bad at all.

The Commerce Department report, which will come out in final form in another month or two, said 1.1-million new homes were constructed in the U.S. in 1986. Two-thirds of them will be built in the South and West which, because of its limited space-heating requirements, do not offer much market penetration potential for fuel oil vis-a-vis its traditional gas and electric utility competitors (See data in adjacent box).

Fuel oil marketers said last year's depressed prices helped the industry's competitive position with gas and, especially, electricity. As an example, the Maine Oil Dealers Assn. noted that conversions of electrically heated homes to fuel oil "are going stronger than ever, up between 12% and 18% over previous years depending upon the region" in question.

The New England Fuel Institute also noted some time ago that its continuing promotional and educational efforts, as well as a more competitively priced product, enabled its members to staunch the flow of conversions from oil to gas; in effect, to have fought the utilities almost to a standstill.

Construction Report Boosts Oil Heat

For an industry segment that has been lagging badly in the new home construction market in recent years, fuel oil got an important picker-upper in 1986, preliminary data from the Commerce Department says. In the Northeast, oil heat got 24% of the new homes last year, up 8% from 1985. For the nation as a whole, fuel oil got 5% in 1986 compared with 3% the preceding year and 1% to 2% in earlier periods. Here's the breakdown:

Region	New Homes Completed (Add 000)	Share of New Homes by Fuels and Percentages Gas	Electric	Oil	Other
Northeast	193	41%	31%	24%	4%
Midwest (a)	170	78	17	(*)	4
South	502	30	66	(*)	3
West	253	64	29	(*)	7
Total 1986	1,118	47%	44%	5%	4%
Total 1985	1,072	44%	49%	3%	4%

(a) Formerly called "North Central;" (*) Statistical data did not meet publication standards.
Source: U.S. Department of Commerce, 1986 construction reports, preliminary data released in March, 1987.

Shell bumps Amoco and Sun on Jersey Turnpike

Shell outbid Amoco and Sunoco for 13 stations on the New Jersey Turnpike, which runs from the New York State line to the little resort-fishing center of Cape May.

The New Jersey Turnpike Authority announced the awarding of the bid and the changing of the guard as of April 1 but did not release volume or price details. It is understood, however, that all of the stations are in the high volume range.

The package cannot help but enhance Shell's position as the nation's No. 1 marketer of gasoline, a title it won in 1986.

The stations are basically independents, so this will be a branded supply operation. Shell said its own basic credit and Signature Cards will be honored at all of the stations as well as MasterCard and Visa.

Puerto Rico subsidiary is up for sale again

Chevron Corp. says Carey Energy Corp., New York-based trader and marketer, missed its closing date for its planned purchase of Chevron's Caribbean Gulf Refining Corp. subsidiary in Puerto Rico and that other options are now being explored.

Carey signed an agreement with the San Francisco company to pay $100-million for 100% of the Puerto Rico unit which owns a 38,000 b/d refinery at Bayamon and markets products through 275 branded stations on the island. Chevron indicated it's still interested in disposing of the package down there and is discussing other alternatives in addition to continuing talk with Carey.

NPN

NATIONAL PETROLEUM NEWS MAY 1987

Shell Flies High As Leading U.S. Gasoline Marketer

Dwarfed by Exxon and outranked by Chevron, Mobil and Texaco in physical assets and service stations, Shell Oil Co. nevertheless became the nation's No. 1 marketer of gasoline in 1986.

Shell, with a 20.4% increase in volume last year, vaulted over Chevron, Texaco and Exxon—in that order—in finally nailing down a title that had been sort of a will-of-the-wisp challenge through the years. It ranked fourth last year but had been as high as second in prior years.

Probably the biggest single factor enabling Shell to fly so high in 1986 was its acquisition of 400 service stations in the Northeast from Arco during that company's withdrawal from eastern marketplaces. Virtually all of the stations were big volume outlets in prime locations.

Shell said its service stations enjoyed an 11% increase in sales in 1986, the best performance record of any of the top companies in that period. The next biggest percentage increase was Mobil's, with 9.9%. But Mobil's included both service station and other sales so this is not necessarily a quid pro quo comparison.

There were two other significant changes in the line-up of the top 15 gasoline marketing companies: Standard Oil Co., formerly Sohio, moved up one notch, passing fading Arco in the process, and Marathon was added to the top 15 for the first time.

In bygone years, Marathon had been reluctant to disclose its gasoline volumes so it was hard to get a good fix on where it stood nationally. Now, however, Marathon is ranked ninth based on its sales of more than 4-billion gal. of gasoline in 1986. It also inserts Marathon ahead of Unocal, Sun and Phillips in gasoline marketing importance.

In taking over first place, Shell bumped Chevron, which held the lead since its late 1983 acquisition of the old Gulf Oil Corp. At that time, Chevron made an equally spectacular leap upwards, going from fifth to first in one fell swoop.

What hurt Chevron in 1986 was that it had shed 4,000 stations in the Southeast in late 1985 and about 3,000 more in the Northeast in early 1986. The southeastern stations were divested as a result of a court order in the Gulf merger and the northeastern stations were a withdrawal from a marketplace where it had only marginal interests.

Pump islands at Shell service stations were busier than ever in 1986 as the company moved to the head of the parade in U.S. gasoline market share.

The southeastern stations were sold to Standard Oil and those in the northeast to Cumberland Farms, Canton, Mass., the big C-store chain.

Chevron's gasoline volume in 1986 declined 3.3%. It and Phillips Petroleum, which reported a 1.2% decrease, were the only two "losers" last year.

The net result of the Shell ascendency, however, is that Chevron became No. 2, Texaco No. 3 and Exxon No. 4 (See related table on Page 31).

Dallas-based Southland Corp. was added to the list of 15 this year because even though it's nominally a C-store chain it also is a major gasoline marketer. Moreover, it has its own refinery in Lake Charles, La., a 100,000 b/d facility that is operating at almost full speed. Southland's volume in 1986 was a little over 2-billion gal.

The two biggest "pure" gasoline marketers—that is, those without refining facilities of their own—are Cumberland Farms and Getty Petroleum Corp. Cumberland noted that it had obtained control of the former Chevron-Gulf properties in mid-1986, thus it did not have a full year of operations under its belt by Dec. 31. A spokesman indicated, however, that earlier this year it was moving about 1.7-billion gal./year. That's rather surprising because Cumberland previously had been credited with about 2.5-billion gal./year.

Getty reluctantly refused to reveal its gasoline volume in 1986 so here again it was difficult to give it a proper ranking. However, the last estimates were that Getty was moving about 1.25-billion gal. of gasoline in its 11-state market area.

Cumberland, while not owning and/or operating a refinery, is about as close to it as a company could be without the formalities. Cumberland has a contract arrangement with Newfoundland Refining, Inc., under which the old Canadian refinery will be put back on stream later this summer. It is owned by an independent investor group but Cumberland is handling the crude oil purchases and has committed

(Continued on page 30)

Retail Market Shares, Continued . . .

The 1986 Gasoline Market by Gross Gallonage and Relative Shares

1986 Volume = 109,105,160,000 gal. (a)
1985 Volume = 108,876,519,000 gal. (b)

Company	Rank 1986	Rank 1985	Share of Natl. Mkt. 1986	Share of Natl. Mkt. 1985	Volume (Add 000 gal.) 1986	Volume (Add 000 gal.) 1985	% Chng. '86 vs. '85
Shell	1	4	8.711%	7.251%	9,504,600	7,894,500	20.4%
Chevron	2	1	8.396	8.702	9,160,020	9,473,940	(3.3)
Texaco	3	2	8.009	7.885	8,738,100	8,584,800	1.8
Exxon	4	3	7.714	7.589	8,416,170	8,262,870	1.9
Amoco	5	5	7.348	7.181	8,017,590	7,818,300	2.6
Mobil	6	6	6.716	6.125	7,327,740	6,668,500	9.9
Standard	7	8	5.019	4.914	5,475,480	5,350,170	3.7
Arco	8	7	4.609	4.266	5,028,210	4,644,990	8.3
Marathon	9	9	4.047	3.830	4,415,040	4,169,760	5.9
Unocal	10	11	3.653	3.421	3,985,800	3,725,190	7.0
Sun	11	10	3.442	3.450	3,755,850	3,648,540	2.9
Phillips	12	12	3.414	3.365	3,725,190	3,663,870	(1.2)
Conoco	13	13	2.740	2.647	2,989,350	2,882,040	3.7
Southland	14	14	1.879	1.819	2,050,000	1,980,000	3.5
Getty	15	15	1.096	1.014	1,195,740	1,103,760	8.3
Total (c)	—	—	**76.8%**	**73.1%**	**83,784,880**	**79,571,230**	**5.3%**

(a)Estimated on the basis of Federal Highway Administration data for 1985 consumption, plus 2.1% reflecting 1986 increases.
(b) Federal Highway Administration consumption data for 1985.
(c) Specific data on Cumberland Farms, which has been regarded as the nation's biggest independent retailer, are not available because the firm did not acquire control of its Chevron/Gulf purchases until mid-1986; hence data for a full year are not available. Estimates, however, indicate Cumberland is retailing about 1.7-billion gal./year. Because the Cumberland figure is inconclusive, it is not included in the industry total in the final line above.
Sources: Federal Highway Administration as well as 1986 annual reports on gasoline sales volumes. Some companies concede, however, that the volumes include varying amounts of other products, such as avgas and naphtha. Thus these figures are more of a trend than a specific.

itself to buying all of the product—about 100,000 b/d—for its American marketplaces. [*NPN*—Apr. '87, p22]. Thus, it controls all of the needle except the eye, so to speak.

The gasoline volumes in this evaluation are those reported by the oil companies in their annual reports and ancillary financial statements. The volumes are total sales, not just those designed for highway use. They can, consequently, include highway use, inter-refinery sales and other distribution procedures. Also, some companies say the gasoline totals may include small amounts of related products such as avgas and naphtha. Federal Highway Administration highway consumption data for 1985 and 1986 are used as a roundhouse estimate of this marketplace as a basis for comparisons.

Exxon is the nation's biggest oil company, with $69.1-billion in assets. Mobil is second with $41.8-billion, then Chevron with $38.9-billion, Texaco with $37.7-billion and Shell with $26.5-billion, just a step ahead of Amoco with $25.2-billion.

In the number of service stations, the last available figures credited Texaco with 18,718, Exxon with 17,427, Chevron with 16,645, Mobil with 13,310 and Shell with 11,129. There were many changes in 1986, however, so these totals will probably vary up or down when the late 1986 numbers become available this spring.

Chevron Leads in Refined Products But Gasoline Ratio is Lowest

Chevron sold more refined petroleum products in 1986 than any other major oil company but its ratio of gasoline sales was at the other end of the spectrum as well.

Most of the companies ranged relatively close to a 50/50 sales ratio between refined products and gasoline. Refined products normally include light and heavy fuel oils, lubricants, asphalts, etc.

Chevron marketed 23.7-billion gal. of refined products in 1986, down 8.1% from 1985 but still far ahead of second-place Texaco which sold 18.8-billion gal. over the same time frame, up 6.1% over the preceding year.

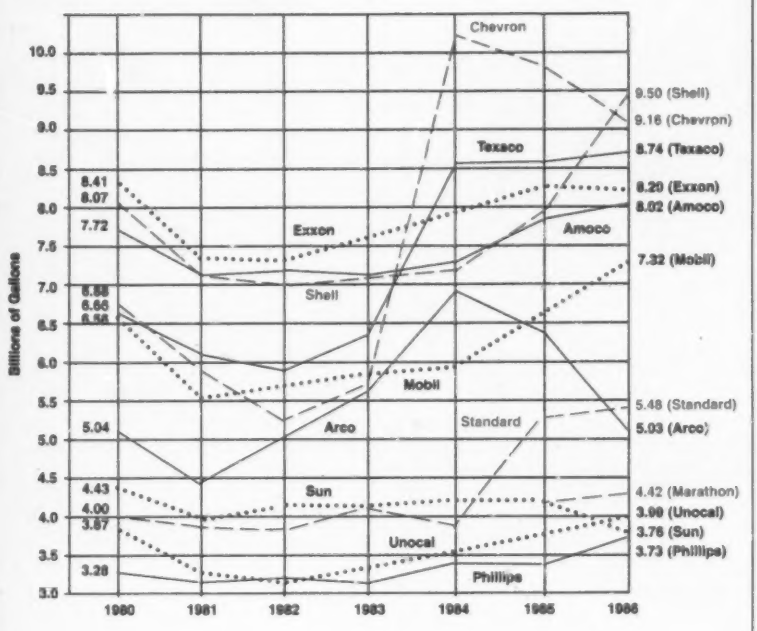
Chevron's gasoline ratio was only 39% while Texaco's was 47%. The highest gasoline ratio was Unocal's, which was 59%. Shell, which ranked first in gasoline sales in 1986, had a ratio of 53% in gasoline sales to total refined products. Shell also had a spectacular increase in total product sales, 23% over 1985.

Here's a boxscore of the 1986 ratios with an additional factor ranking the top 12 companies in the value of the assets they own and use in their operations:

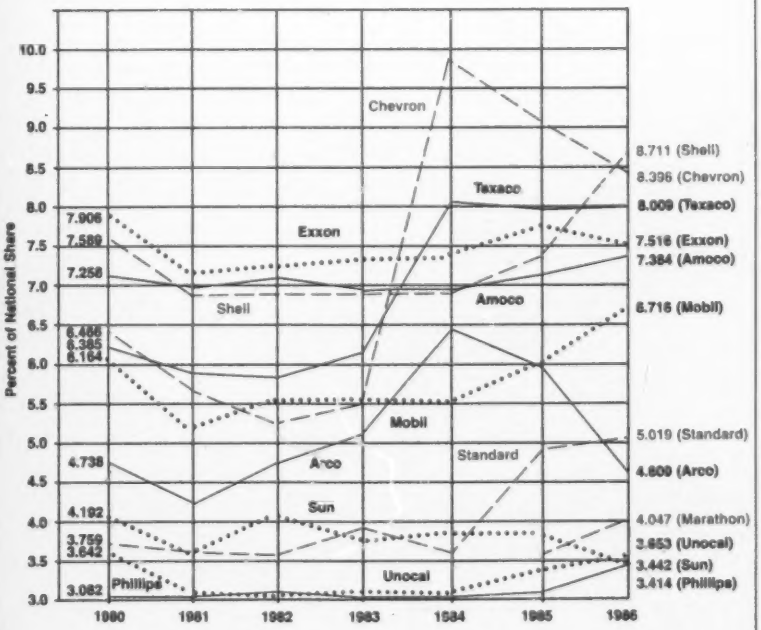
Ranking in Assets	Company	Refined Product Sales 1986	Refined Product Sales 1985	% Chng.	% Gasoline
3	Chevron	23,715,510	25,800,390	(3.1%)	38.6%
4	Texaco	18,809,960	17,721,480	6.1	46.5
5	Shell	17,982,090	14,609,490	23.1	52.9
1	Exxon	16,954,980	17,215,590	(1.5)	48.7
6	Amoco	14,348,880	13,966,630	2.7	55.9
2	Mobil	12,892,530	12,095,370	6.6	56.8
7	Arco	10,163,790	9,519,930	6.8	49.5
8	Standard	9,887,850	9,259,320	6.8	55.2
10	Sun	8,278,201	8,109,570	2.1	45.4
12	Marathon	7,894,950	7,220,430	9.3	55.9
9	Phillips	7,864,290	8,094,240	(2.8)	47.4
11	Unocal	6,775,860	6,438,600	5.2	58.8

THE BIG PICTURE

In Billions of Gallons



By Market Shares



Alcohol Blends Gaining Support in Washington

Alcohol fuel producers could soon have their greatest growth period in history as officials on Capitol Hill and in the Reagan administration look at ethanol and methanol as a way of curbing air pollution—and U.S. dependence on foreign oil—while at the same time helping the nation's corn growers.

Vice President George Bush recently proposed using ethanol in all gasoline sold in parts of the U.S. "that violates carbon monoxide pollution limits [*NPN*—April '86, p11]." Metropolitan areas in New York, New Jersey, Massachusetts, and Colorado are among 88 urban areas not in compliance with air quality standards issued by the Environmental Protection Agency (EPA).

"Instead of storing crops and taking federal payments," Bush said corn growers "could sell them to the energy companies that would spring up," as well as to existing ethanol producers.

Eric Vaughn of the Renewable Fuels Assn. regards the Bush proposal as a "boost" for ethanol producers. He says, "Bush's statement may signal a change in the Reagan administration," which has not supported efforts to require alcohol fuels.

Vaughn says the increased use of ethanol and methanol in the U.S. is inevitable.

"Cities are choking," he says. "There may be EPA sanctions on 88 localities by 1988, and they need to show by the end of the year they have plans for attainment (to meet air pollution standards)."

Many legislators in both the House and Senate also are urging the government to consider ethanol and methanol as a new approach to curb urban air pollution.

Sen. Larry Pressler (R-S.D.) has presented a non-binding resolution to the Senate "urging the federal government to encourage the increased use of ethanol and methanol to reduce air pollution, U.S. grain surplus and provide other benefits."

Pressler is one of several legislators who would like diesel buses and trucks to switch to methanol.

"Diesel trucks and buses emit 30 to 70 times more toxic particulate matter than conventional engines . . . the shift to clean-burning methanol significantly reduces bus emissions," Pressler says.

Meanwhile, a study prepared for the Rocky Mountain Oil and Gas Assn. estimates the costs of requiring alcohol fuels would range from approximately 3.5¢ to 7.0¢ more per gallon than conventional gasoline.

Studies have determined that use of a 10% blending of ethanol in gasoline significantly reduces carbon monoxide levels from car exhaust. *NPN*

West Coast Battle Heats Up As Arco Defends Big Gains

For 80 years or so, or almost ever since the old Standard Oil of California and Royal Dutch/Shell opened the first service stations in Seattle, major oil companies have sporadically fought pitched battles for market position on the West Coast.

This birthplace of such things as self-service and high-volume pumpers has never seen anything quite like what has been going on since early 1982, though.

Arco, at that time, threw down the gauntlet by tossing out its credit card and adopting the independent's low-price, high-volume marketing strategy. It later withdrew from the East Coast and Midwest, and let one and all know that the West Coast was now its playground.

By Mark Emond
Contributing Correspondent

Many competitors thought Arco's management had taken leave of their senses by dropping their credit card. They were convinced of it when the company slashed its prices to depths far below the market and kept them there. Some said, hopefully, just wait until their earnings reports come out showing deep losses and we'll see an end to this foolishness.

What competitors didn't realize was that Arco's strategy had been carefully plotted since the early 1970s. It had streamlined its refineries to make them among the most efficient in the industry, had made sharp reductions in its personnel overhead and had figured out how to make more money on high volumes and low margins rather than the other way around.

And, the company owned a whole lot of crude oil in Alaska.

"The (other) majors thought we were making a colossal mistake (in dropping the credit card)," gloats George Babikian, Arco Petroleum Products president and chief architect of the program. "Their reasoning must have been, 'Let them go to it. They're going to go right down the sewer.' "

That didn't happen.

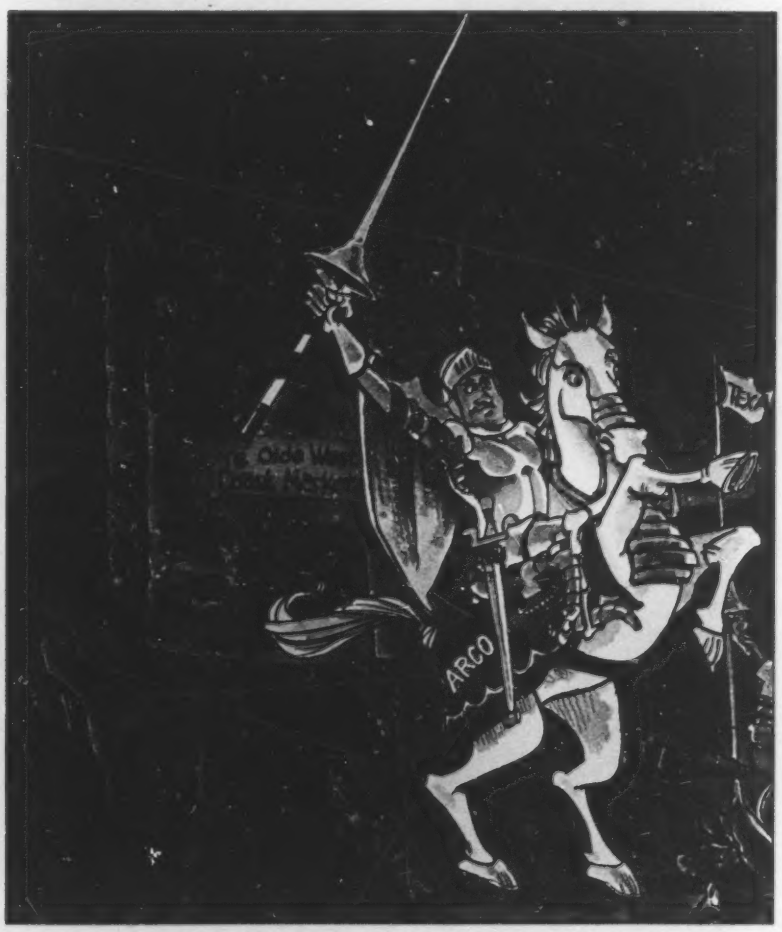
Instead, this "bad boy" among the majors has blown away most of its major company competition and has sent big-name independents scurrying to get under a major flag, preferably Arco's. Slashing its prices 6¢ to 8¢ gal. and often more, Arco's gallonage and marketshare have zoomed to lofty heights at the expense of others.

Arco has already replaced Chevron as California's No. 1 gasoline marketer—something most competitors said would never happen—and is on the brink of grabbing the top spot from Chevron in all of the seven-state PAD 5 marketing region.

Today, some competitors grudgingly admit that Arco not only knew what it was doing in 1982 but came up with one of the smartest marketing strategies the region has ever seen. Says one independent: "Arco has not just fundamentally changed oil marketing (on the West Coast); it has changed the whole oil industry . . . for the good, in terms of efficiency and yield to stockholders."

That may be so, but in running roughshod with Mexican spurs over its competition, the company has caused a lot of wounds and rubbed salt in them. Other majors, still a little stunned by Arco's rapid climb to the top, are now believed to be plotting strategies of their own to regain lost ground. New battles lines, it's believed, are being drawn.

Just about everybody in the West is watching to see if some major, perhaps Chevron, won't now fling down its gauntlet and take the upstart Arco on.



Big Stakes

Few doubt that a new Battle Royal is shaping up, something not that unusual for this region. Both the major oil companies and big-name independents have always played for keeps when rolling their marbles into this volatile market, and with little wonder.

It is an enormous gasoline market.

One of every 6 gal. of gasoline sold in the United States is sold in the seven-state PAD 5, one of every 9 sold in the U.S. is

Arco's aggressive gasoline marketing strategy has moved the company to within a whisker of being the number one gasoline marketer on the West Coast. In 1986, Arco edged ahead of Chevron to become the number one California marketer. The company's average station throughput in the huge Los Angeles market is a phenomenal 175,000 gal.

sold in California, and one of every 23 is sold in the Los Angeles Basin.

Los Angeles, the world's largest gasoline market and Phoenix are known as the land of ultra high-volume big pumpers. Big-time independents have been known to give away Cadillacs in Los Angeles to build volume. Some majors have dropped millions just trying and failing to enter the region.

It is, without question, a market worth fighting for, if volume and the economies of scale associated with high gallonage are what is desired.

That is exactly what Arco sought and the company has simply "cleaned just about everybody's plow," as one competitor puts it, since kicking off its drive five years ago.

Arco in 1986 had 16.74% of the California market compared to runner-up Chevron's 15.62%, according to Lundberg Survey Inc., although Chevron has roughly twice the number of stations in the state that Arco has. In PAD 5 as a whole (Washington, Oregon, California, Nevada, Arizona, Alaska and Hawaii), Chevron still leads in gasoline market share in 1986 with 16.36%. Arco, however, had 15.68% of the total PAD 5 market last year compared to just 9.93% in 1981. Arco's gains have been so relentless, it seems to be only a matter of time before it becomes No. 1 in the entire region.

In Los Angeles, Arco has established a phenomenal record, pushing its market share to 23.3% and its monthly average station throughput to 152,000 gal. in 1986, according to Whitney Leigh Corp., a market-research firm specializing in tracking gasoline statistics in selected metropolitan markets. Arco reports the average at its own stations in the area is 175,000 gal. a month.

Arco's Los Angeles throughput is twice the industry average and a long way out in front of the 106,000 gal. average of second-place Shell in per-unit throughput.

Arco's success in Los Angeles looms large for two main reasons: First, the market is so big and profitable. It dominates the state and, to a lesser extent, the region. Los Angeles represents 40% of California's total gasoline sales and 28% of PAD 5's. Second, and strategically more important, Los Angeles is a blueprint for Arco expansion elsewhere. The company has declared its intention to spread its Los Angeles success to other markets. It has turned its guns on Arizona, with already striking results, and is getting ready for an invasion of northern California, two areas in which it has been relatively weaker.

The Arco Strategy

Arco, in effect, became a fighting independent in major guise, combining the guile and aggressiveness of the independent gasoline marketer with the economic power of a major integrated oil company when it launched its blitzkrieg in early 1982.

In addition to adopting the independent's low-price, high-volume gasoline strategy, Arco also made a heavy commitment to convenience food stores at a time when most other majors still had committees studying the feasibility of such things.

Today, the combination of Arco's am/pm C-stores and high-volume pumpers seems to be almost unbeatable.

Two essential features of Arco's program are its low self-serve prices, ostensibly justified by the elimination of credit cards, and the am/pm stores, which provide traffic and ancillary income enabling dealers to live with very low margins.

The C-store chain started as far back as 1972. In its early years it was a mongrel mixture of designs, colors, and merchandising programs. By 1978-79, "we had 300 of these and hundreds more were planned," says Babikian. "We said we had to bring this under control, and that's when am/pm was created. We standardized the color, the promotions, the store layout, and what we were selling. It just took off."

With 500 am/pm stores in 1986 and plans for 1,000 by 1992, Babikian calls it, "the most successful program ever implemented by marketing."

'Being No. 1 isn't paramount, but the volume is'

Arco is even building am/pm stores alone, with no gasoline, just for the profits they churn out. One such store is doing $3,000-$3,300 a day from 6 a.m. to 7 p.m. Arco plans to build "half a dozen" more stand-alones and start another franchise if they're successful.

In Arco's view, the battle that it launched in April, 1982, for West Coast supremacy was basically won in a few short months. Says Babikian, "By the fall of 1982, it was absolutely over with." Arco had doubled its station volumes, and intended to keep them.

"Obviously, we weren't going to lose the volume we got. And that's been our position since day one," he explains. "We're not in business for sport; we want to make money, too. But we've got a vested interest in what we've done, and we're going to protect that."

Being No. 1 isn't paramount, but the volume is, says Babikian. "What we don't want to give up is the economy of scale. That's absolutely essential to our program. If our dealers lost 50,000 gal. a month, they couldn't do what they're doing."

The "chest thumping" Arco did after blowing up its credit card in multimedia advertisements was deliberate. "We didn't want anyone else to get rid of the credit card," says Babikian. "When the figures came out and they saw the phenomenal increases we were experiencing, we didn't want them to copy us."

Babikian went on press tours to all of Arco's principal cities in the country, telling everybody "how great we were," he says. "That was designed to put Arco in the No. 1 position where, if anyone did anything with credit, they knew they were going to be a me-too company. And that worked phenomenally well."

Five years later, nobody has been able to match Arco's low, low prices, and everybody but Unocal is trying to catch up with Arco's headlong am/pm expansion. But nobody's keeping pace.

By Arco's own economic logic, it could be that the company has accomplished enough to be willing to back off, or at least not push so hard. At the same time, though, as Babikian says, the company doesn't plan to give up any of its gains.

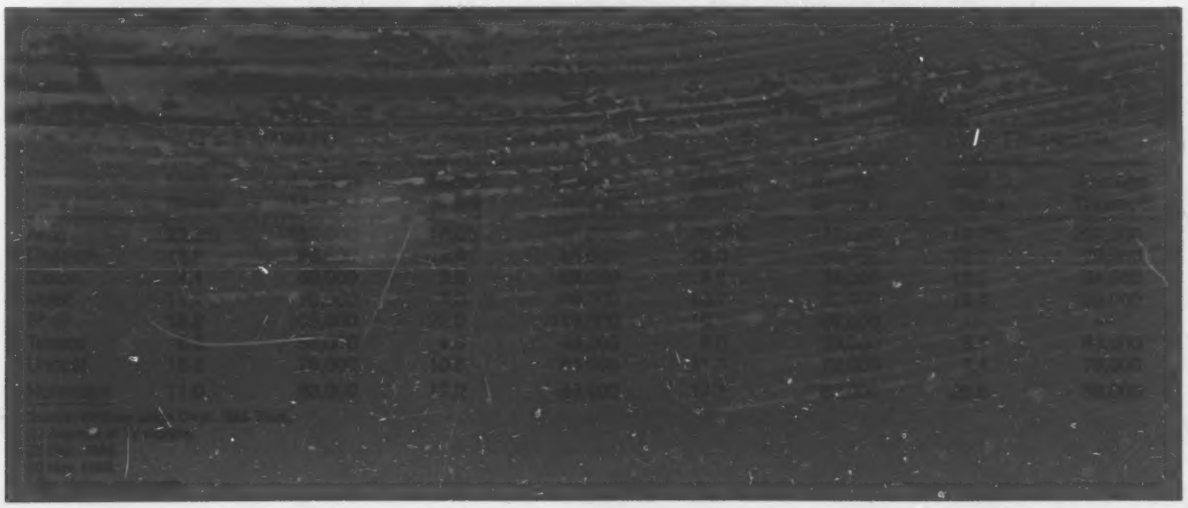
"We're oversold, and have been," says Babikian. "So we could keep that (throughput) volume going up, but there isn't any sense because we don't have the gasoline to do it. Our own stations (in Los Angeles) did 175,000 gal. in December. . . . That's plenty of volume for us in our stations, as an average. We're very happy with that. That makes our whole system work."

Here's how Arco and its principal competitors stand in three other key West Coast markets, according to Whitney Leigh Corp. "Gas Track" reports:

In the San Francisco Bay area, Arco's average station throughput in December 1986 was 168,000 gal., with Shell at 118,000 and Chevron at 86,000. However, Arco ran third in market share with 14.0%, compared with Shell at 22.9% and Chevron at 19.9%. In Phoenix, Arco's

George Babikian

'What we don't want to give up is the economy of scale. That's absolutely essential to our program.'



average station throughput in December 1986 was 202,000, with runnerup Mobil at 100,000. Arco was first in market share with 18.7%, followed closely by Mobil with 18.4%. In Seattle, Arco's average station throughput in November 1986 was 112,000 gal., with second-place Unocal at 72,000. Arco was runaway No. 1 with 20.3% in market share, followed by Chevron with 13.0%. (For a summary of Whitney Leigh market shares and average station throughputs in Los Angeles, San Francisco, Phoenix, and Seattle, see accompanying table.)

By the principle Babikian enunciated, the throughputs in all of these primary markets would appear to satisfy Arco's system requirements. The company's market-share requirements, whatever they may be, aren't known. In any event, it doesn't mean Arco will stop pushing.

Wherever Arco does not have what it considers sufficient volumes to make the system work, it appears to be a practical certainty that the company will continue to push, within supply limitations.

As long as consumers remain price conscious and Arco continues to have ample economical products, the company's current program will probably continue much as is.

Arco's Alaskan production will begin to decline in 1989, unless the company further enhances oil recovery or makes another significant discovery, for which competitors are not ardently wishing.

What Arco's Competitors Are Doing

Arco's major competitors do not delude themselves about the company's success. This includes Chevron, which bore the brunt of Arco's attack.

"You really must give Arco a helluva lot of credit for what they did when decontrol came," a Chevron marketer says. "They radically changed their way of doing business." In Los Angeles, "they really cleaned our plow," he adds.

Throughout the West, frenetic market repositioning is taking place, with some companies deliberately pursuing an identity or niche.

Arco has chosen the price end of the spectrum, Unocal the service end. Shell believes strongly in its quality credit-card customers and credits its success to knowing who its customers are.

Says a Shell marketer, "I think there are going to be two marketers on the West Coast in the future, Arco and Shell. Those are the two companies that know who their customers are. You can't be all things to all people."

The market changes Arco saw when it fundamentally revised its way of marketing were not seen as clearly by others, if at all.

Chevron, the traditional full-service marketer par excellence, got caught in a shifting riptide. "Times came real hard for a historical full-serve operator like ourselves," a Chevron marketer says. "The world changed and the market got competitive, and pricing suddenly became the No. 1 factor. Whereas from 1973 to 1981 all people were interested in was getting product."

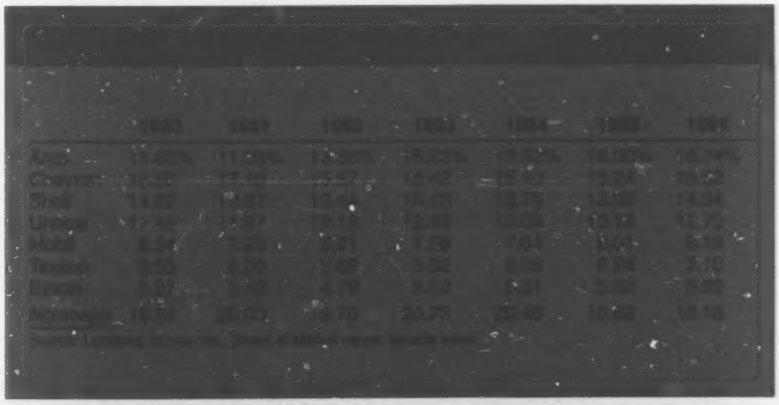
Because of Chevron's geographic representation, brand acceptance and other factors, Chevron dealers had become used to fat margins, with some stretching to 18¢ gal. at the time of decontrol.

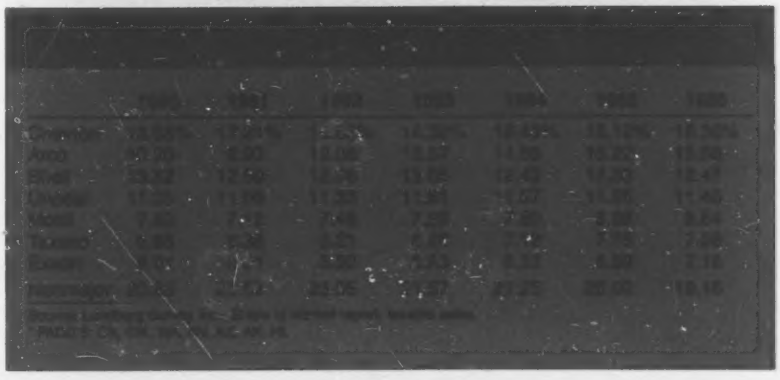
With rental incentives, rebates, and counseling, some Chevron dealers have become much more competitive, but many are still obtaining relatively wide margins, holding up the average.

Chevron has embarked on an ambitious investment program, eliminating many marginal units, including many conventional outlets. While still building some conventional stations, the company is going for a wider mix, particularly "pumpers" with ancillary profit centers, mainly C-stores.

In a $600 million upgrading program, Chevron is building several hundred C-store stations of its own, on top of some 2,300 mostly jobber outlets already operating across the country.

"We didn't start our investment program until halfway through 1984," a Chevron marketer says. "We've got a combination now of good merchandising





Chevron is moving up fast on station throughputs

Unocal is marching to a different drummer among West Coast majors, moving in the direction of multibay, automotive service, full-serve and split island stations.

and sound investments, and that's what's giving us increases."

Chevron's California gasoline market share fell sharply to 15.57% in 1982 from 18.50% in 1980, and leveled off after that, Lundberg Survey data shows. In PAD 5, after falling to a low of 15.63% in 1982, Chevron's share increased to the 16.12-16.43% range in the years since then. (For California and PAD 5 market shares, see accompanying tables and graphs.)

In greater Los Angeles, Chevron shows the largest gains in average station throughput, with 86,000 gal. in 1986, up almost 70% from its 51,000 in 1983, according to Whitney Leigh (see graph). In market-share growth there the past three years, Chevron (33%) is second only to Arco (46%).

"We'll catch those other suckers," says a Chevron marketer. "It's going to take us a while. Realistically, I don't say we're going to catch 160,000 in a short period of time, but I think we can catch the other folks who are 100,000."

Shell, the No. 3 marketer on the West Coast, has been a leader in station design for many years, and has been quick to expand its chain of high-volume self-serve-only stations. Old stations, and even relatively new ones, are being torn down and replaced with what competitors call "beautiful" units.

Says an independent refiner, "They've got a premier retail system that does a superb job. I think they sell all they have. They could be a lot tougher if they wanted to be."

Mobil, Exxon, and Texaco are a mixed bag, competitors say. Mobil has plowed a lot of money into some markets, but isn't showing much volume gain. Exxon is tough in dealer-tankwagon pricing, but isn't trying to expand, a mystery to others. Texaco is building some big, new stations, but is burdened by heavy reliance on distributors, many of whose stations are low volume and do not measure up to the new standards.

Unocal is one West Coast player which appears to be remaining aloof from the volume fray that seems to be shaping up. It has its sights on the full-serve and automotive-service niche.

The Unocal Way

Unocal's primary objective is to specialize in the automotive service that most other oil companies are vacating or de-emphasizing.

Says Clay Warnock, Unocal vice president of refining and marketing, Western region, "I think Arco and Unocal have done the best job of carving out a special niche in the marketplace; they're at one end and we're at the other.

"We've thought our strategy out very carefully over the past four or five years, and we keep examining that strategy, and by design we are filling the vacuum that's being left in the marketplace in the way of automotive services."

Warnock believes the changes Arco started in 1982 are accelerating, not slowing, with other companies "getting further and further away from the traditional service-oriented type of marketer."

He explains, "Basically, it's the convenience-store type of operation that almost every major, with the exception of one (Unocal) is embarked on in the Western corridor, from Bellingham, Wash., to San Diego."

On the contrary, "our direction is toward the multibay, full-serve, and split-island station that basically has the capability of handling large volumes of gasoline, but able to give full-service too, and to handle the automotive-service needs that are becoming more and more in demand," he says.

Unocal is expanding service professionalism as never before, with five training centers and an extensive "Protech" auto-care program. The company has 32 "superfacilities" so far (4 to 6 bays), with 9 more under construction.

"We just ran some numbers on our superfacilities, and the average throughput was between 135,000 and 140,000 gal., with backroom sales that average a little over $40,000 a month," he says. Unocal sold $30 million of TBA (tires, batteries, and accessories) in 1986.

Warnock believes Unocal's strategy gives it long-term benefits. "To reverse the position many of the majors have taken throughout the country would take tremendous amounts of capital," he says. "You just don't overnight go back and open up all those bays."

The Independent Dilemma

Another aspect of Arco's rapid expansion since 1982 has been branding up or buying high-volume independents. When its station throughputs peaked and leveled off, Arco aggressively signed up some of the most competitive private-branders and open dealers, and also purchased choice stations in many markets. "We were allowed to get away with that, too," says Babikian.

West Coast independent gasoline marketers, however, feel squeezed from almost all directions. Those who haven't cut a deal with Arco feel backed to the wall because of aggressive Arco pricing. They are increasingly restless about the diminishing supply of products from independent refiners. They are caught in the middle of feuding majors, with visions of worse to come.

Things are bad enough even if they don't get worse. Says Herb Richards, president of Coast Oil, San Jose, Calif., "All the companies are closing two stations and spending money on one, and

they want to get more gallonage out of the one. Somebody that was doing 15,000 (a month)—they want to be doing 115,000."

"They're getting rid of a lot of the old-time dealers. The ones they're leaving behind are very, very competitive. They've got these guys scared because they've been told if they don't do this, they're going to close the station up."

The ranks of lessee dealers are being decimated as suppliers shut down stations and convert conventional automotive-service stations to self-serves and C-stores. Dealer leaders like Steve Shelton in southern California, Jim Campbell in northern California, and Tim Hamilton in Washington are fighting the trend, but with limited success. One victory is the passage of some local ordinances banning conversion to self-serve.

Independents criticize Arco for cutting prices deeper than necessary—"leaving money on the table," it's called. This was a universal criticism until recently, lessening as Arco is reported to be easing off at times.

"In the past it was evident Arco was leaving a lot of money on the table," says a Shell marketer. They were giving their dealers such attractive DTWs (dealer tankwagon prices), they could undercut anybody at will at retail, and did so.

"I don't see the dealer retail pricing quite as competitive as it was, but it doesn't seem to be stopping them any (in sales), which proves the point that Arco did leave money on the table before. They didn't need to be as tough as they were, because their share of market indicates they are still doing great guns out there (at higher DTW prices)."

There is no niche for independents in commercial markets, even for products like lube oils. Since Arco doesn't market to commercial customers, other majors, particularly Chevron and Unocal, reportedly make the most of it.

Fred Bertetta Jr., president of Olympian Oil Co., South San Francisco, is shocked by Unocal. "The major problem area is majors going after commercial business, especially Union Oil," he says. "I've seen Union go in and quote prices to commercial accounts that are so far below what they're selling for to their branded dealers, it's unreal." He mentions the case of Yellow Cab at 6¢ gal. below.

"Unocal leaves more money on the table in the commercial business than anybody," says Bertetta. "They leave a ton of money on the table. If they want an account, they just keep dropping and dropping until they've got the guy. No doubt about that one. They leave so much money on the table on their 30 weight motor oil, their bids are a joke."

Many independents are giving up the uncertainties of private-brand marketing and branding major, for security of supply and margin protection. This adds to their loss of market share as a group.

In the seven West Coast states (PAD 5), independent market share of taxable gasoline gallonage has dropped to 19% in 1986 from 24% in 1981, the Lundberg Survey reports. In California, their share dropped to 18% in 1986 from 21% in 1983.

The record appears to be considerably worse in key metropolitan areas. According to Whitney Leigh Corp., gasoline volume of nonmajor marketers in greater Los Angeles fell to 11.0% in 1986 from 22.2% in 1983.

The list of private-branders who have branded up or sold at least some of their stations is like a who's who of independents: World, Thrifty, Douglas, USA, Awful Bros., Herbst, State, U-Save, Time, Coast, Wickland, Gull.

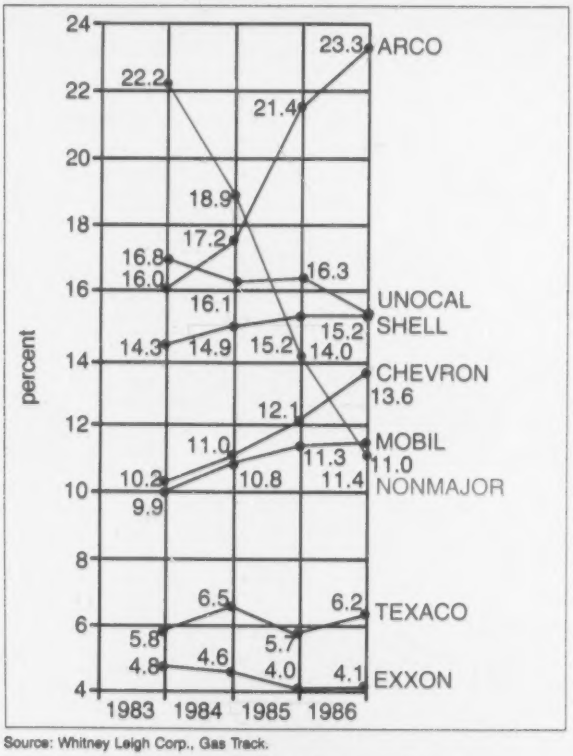
The overhanging threat for most independents is a possible declaration of war against Arco by one or more majors, although there are differing views on what this would mean to independents.

"My concerns are that if Chevron and these other companies make a run at Arco," says Bertetta "we're going to have to hide behind a rock, because the crossfire would wipe us out."

Bertetta has already deemphasized retail marketing because of Arco pricing. "Wherever Arco is, there is no way," he

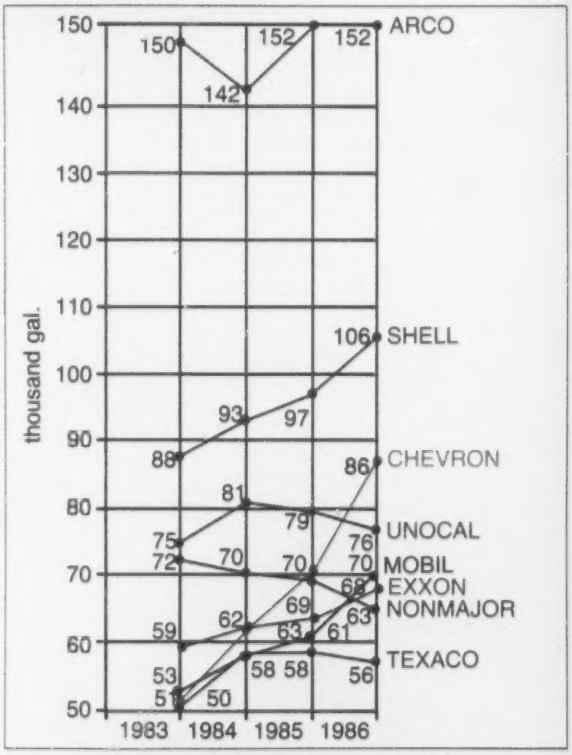
A war between majors could spell trouble for indies

Battle report from the world's largest market



Source: Whitney Leigh Corp., Gas Track.

Greater Los Angeles gasoline market share, 1983-1986.



Greater Los Angeles average station gallonage per month, 1983-1986.

says. "There is no way to stay across the street from Arco, for us. Where there are no Arco's, we can make something out of it."

Says Walt Dwelle, senior vice president of marketing, Beacon Oil, a California integrated independent, "My opinion is that over the long haul it may be the best thing if somebody takes them (Arco) on, like Chevron. Sure and hell it would be a bloodbath for all of us, maybe for a year, but it probably could get this market straightened out.

"Arco has been pretty much having their way ever since they blew up their credit card. I kind of wish that that had happened the minute Arco took off on this track, and we'd probably have a much stronger market now because of it. Chevron could do it, certainly, but it's not going to be easy."

Some marketers don't give Chevron much of a chance of successfully challenging Arco. "Chevron lost $128 million downstream in the fourth quarter of 1986," says one. "They simply can't compete with Arco because they don't have the economies of scale. If Arco wants to stop Chevron in their tracks, they will prevent them from getting those economies of scale."

Others think Chevron can clobber Arco. Says Jay Colin, president of State Oil, Los Angeles, "I've got news for them (Arco). They'll be buried by Chevron. Chevron has got better corners. Sooner than later they're going to rebuild them all, and they're going to tell Arco where to go."

Independent gasoline marketers used to be able to buy from 10 or 15 significant independent refiners several years ago, but are now down to only five or six.

Independents consider Tosco their main source of supply, followed by Champlin. Exxon is a big supplier of other refiners and perhaps brokers and traders, but doesn't do much unbranded business with individual marketers. Other important unbranded suppliers are Tesoro, Wickland, Golden West, Texaco, Chevron, and Gull.

In all of PAD 5, in 1986, the top five independents in taxable gasoline volume (market share in parentheses) were: Tosco (2.90%), Golden West (1.91%), Wickland (1.67%), Beacon (1.48%), and Champlin (1.40%), Lundberg Survey reports. Tosco and Champlin market only at wholesale; the others have retail outlets of their own.

Imported gasoline, mostly from China, is a significant source of supply for independents at times, but it is not as dependable as many hoped. Some 60,000 b/d of gasoline and gasoline blending components were imported into PAD 5 in 1985, but only 47,000 b/d in 1986, the Energy Information Administration reports.

(Continued on page 42)

. . . 'the real battle is yet to come'

Trading in Far East gasoline can be capricious, traders say, subject to many economic influences throughout the world. At any time, the West Coast can lose its attractiveness in the eyes of certain exporters, relative to other markets, and U.S. gasoline importers can be left high and dry.

At most, gasoline imports amount to only 3-4% of West Coast consumption.

What the Future Holds

All indications are that the real battle is yet to come on the West Coast. Unless Arco gets religion, just about everybody expects some major sooner or later to fling down the gauntlet. If it's Chevron that does, Shell and Mobil will almost certainly jump right into the thick of it.

That would be sufficient to make it a generalized war.

Standard Oil of Ohio, with its huge surplus of Alaskan crude oil, is a possible new entrant, but the company has been one for nearly a decade and still has not made the move. Refineries and station chains have been available, and possibly a few still are, but Standard has passed many by and the pickings are getting slim.

"The West Coast is a good market, so you're going to find more and more entrants," says Arco's Babikian. "But it's a tough market to get into. I don't think anybody's going to be able to build a refinery out here.

"Standard seems to have a chance to come out here. They've said they want to if they can do so economically. There are some good candidates available for them, but apparently they haven't been able to work anything out. They've got to buy a refinery system that can be expanded. Tosco seemed like a good one to me. I was surprised they let that one go."

"I have a hunch Standard will be out here before long," says Paul Erdos, executive director of Serve Yourself and Multiple Pump Assn., Los Angeles. "They maintain West Coast contacts, and all it will take is one big buyout and they're here."

Investment banking circles report Thrifty Oil, with its Golden West refinery, and World Oil, with its Sunland refinery, have been totally on the block for some time, with no takers, although some individual station properties have been sold.

The shutdown Powerine refinery has been purchased by some Austrian investors and is supposed to be cranking up, but it isn't considered a likely candidate for whatever ambitions Sohio might have.

But even without new entrants, the West Coast appears to be in for some wild times. There doesn't seem to be any way for retail margins to escape being squeezed even more than they are already. Many independents will manage to stay alive by flying major flags as long as they must. Those who go it alone will have to be more efficient than they have ever been just to survive.

Arco has made its choice to concentrate its entire marketing efforts on the West Coast, and to that decision everybody else is fatefully tied. NPN

What Else They're Saying

"What would I like to see happen? Long lines at the service station. It could happen anytime, but you can't wait for that. I think a normal market would be all right. I hope that Chevron and Arco would have enough sense to find out where their place is and let the rest of us live. Those two kind of scare me if they keep battling each other."

Herb Richards
President
Coast Oil
San Jose, Calif.

"I think Arco is a little less aggressive than they were a year ago and will become less aggressive in the future. When you're No. 1, you've got more to lose if you get too far out of line. They get more and more concentrated, if they cause the market to go down, they're going to be the big losers."

Herb Richards
President
Coast Oil
San Jose, Calif.

"Arco doesn't give a damn about their unbranded business in California, so I don't think independents could consider them a secure source of supply. But their posture in the Northwest is very different from that. In the Northwest a very significant portion of their business is the unbranded market, so there Arco is likely to be a more secure unbranded supplier."

Independent refiner

"Exxon has done basically nothing on the West Coast the past four or five years. They've had occasional new outlets here and there, but for the largest oil company in the world and largest retail gasoline marketer in the world, it's amazing they haven't done more. They're priced very competitively, but that's about it."

Independent marketer

"You can't really do anything about Arco. It gets to the point where if we did try to fight them, there would be a bloodbath. I think other majors look at it the same way. Nobody wants to fight them, because what's the point of running the business in the area if you don't make any money. It's better to leave them alone than to bring everybody into the act."

Major marketer

"Chevron and Shell stay remarkably close to each other (in prices). I'm sure it's by design. They're watching each other. I think Chevron prices off Shell and Shell prices off Chevron. There's very little difference between the two."

Major marketer

"George Babikian is maybe the smartest guy in the oil industry . . . his understanding and his reactions. I have seen how he handles himself and stands his ground in a hostile audience. . . . It's almost hero worship."

Multibrand major distributor